



8011-01

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-88136; File No. SR-ICEEU-2019-019]

Self-Regulatory Organizations; ICE Clear Europe Limited; Order Approving Proposed Rule Change Relating to the ICE Clear Europe Collateral and Haircut Policy and Collateral and Haircut Procedures

February 6, 2020

I. Introduction

On December 4, 2019, ICE Clear Europe Limited (the “Clearing House,” or “ICEEU”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² a proposed rule change to replace the existing Collateral and Haircut Policy (the “Existing Policy”), which currently exists as a single document, with two new documents: (i) a revised Collateral and Haircut Policy (the “Revised Policy”) that would specify high-level policy details and (ii) a new Collateral and Haircut Procedures (the “Collateral Procedures”) that would provide supporting operational and other details for the Revised Policy. The proposed rule change was published for comment in the *Federal Register* on December 23, 2019.³ The Commission did not receive comments on the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 87771 (December 17, 2019), 84 FR 70584 (December 23, 2019) (SR-ICEEU-2019-019) (“Notice”).

proposed rule change. For the reasons discussed below, the Commission is approving the proposed rule change.

II. Description of the Proposed Rule Change

ICEEU is proposing to adopt the Revised Policy and new Collateral Procedures, which, taken together, would replace and supersede the Existing Policy.⁴ The Existing Policy sets out ICEEU’s overall approach to defining the types, amounts and composition of cash and non-cash collateral that ICEEU accepts from Clearing Members (“CMs”) to cover their guaranty fund and margin requirements. The Existing Policy also sets out ICEEU’s overall goal of mitigating price risk it may face when liquidating collateral of a defaulting CM by setting and enforcing a list of acceptable collateral (“Permitted Cover”); setting and applying risk-based haircuts to the value of the collateral (“Haircuts”); setting and enforcing concentration limits on the amount of collateral a CM may post, to provide diversification of the collateral pool (“Concentration Limits”); and ensuring Permitted Cover, Haircuts and Concentration Limits are aligned to the ICEEU’s risk appetite and compliant with applicable legal and regulatory requirements.

⁴ The following description of the proposed rule change is excerpted from the Notice, 84 FR 70584.

The approach of the proposed rule change is the creation of two documents so that elements of the Existing Policy are split between the Revised Policy and the Collateral Procedures. The new documents would retain the high-level policy details from the Existing Policy in the Revised Policy and place supporting detail from the Existing Policy into the new Collateral Procedures. The amendments would also remove certain operational details in the Existing Policy that ICEEU has determined are not needed in the Revised Policy or Collateral Procedures because they are contained in other Clearing House documentation. Further, the proposed rule change would not itself result in material changes to the overall purpose of the policy, the underlying haircut model, or to the eligible collateral, haircuts and concentration limitations that the Clearing House currently imposes. The discussion below describes the information from the Existing Policy that is either being retained in the Revised Policy and Collateral Procedures or information not repeated in these documents because they are duplicative of information contained in other Clearing House documents.

A. Revised Policy

The Revised Policy is retaining the high-level policy goals from the Existing Policy related to Permitted Cover, Haircuts, and Concentration Limits described below.

1. Permitted Cover

The Revised Policy would restate the Existing Policy's overall requirements that Permitted Cover assets be highly liquid with low credit and market risk; are priced in an eligible currency; and entail risks limited to those that ICEEU is able to identify, measure, monitor and mitigate. The specific list of Permitted Cover would not be contained in the Revised Policy (or Collateral Procedures) itself but would continue to be

available on the ICEEU website. The specific principles for accepting Permitted Cover discussed in the Existing Policy would reside the Collateral Procedures as discussed below.

2. Haircuts

The Revised Policy would restate the Existing Policy's overall requirements that Haircuts be based on a model that includes the creditworthiness of the issuer; the asset's market risk and liquidity risk; and market conditions and volatility. Certain details such as those relating to the determination of minimum haircuts discussed in the Existing Policy would be specified in the Collateral Procedures, or in related model documentation. The Revised Policy would also state the general principal from the Existing Policy that wrong way risk with respect to posting of collateral (i.e., the risk that the value of a particular CM's collateral is likely to decline at the same time the Clearing House's risk to the CM increases) would be mitigated through member-specific restrictions and actions rather than Haircuts.

3. Concentration Limits

The Revised Policy would restate the Existing Policy's overall framework for setting CM Concentration Limits. It would provide that ICEEU may limit (i) the absolute amount of each type of collateral that CMs may lodge to minimize concentration and enable liquidity and (ii) the relative amount of each collateral type in a CM's collateral portfolio to prevent overexposure to price movements in individual asset classes. Details regarding collateral management, data and reporting and legal review of enforceability of collateral found in the Existing Policy would be split across the Collateral Procedures, ICEEU's Collateral and Haircut Schedule of Parameters and Reviews (the "Parameters")

and the Model Documentation for Collateral Haircut Model. Where details from the Existing Policy such as intraday and end of day valuation of collateral, ICEEU's investment program, or custody arrangements for non-cash collateral are included in other Clearing House policies, procedures and documentation, such as the Treasury & Banking Services Policy, Investment Management Policy, F&O Risk Policy, Document Governance Schedule and Risk Appetite Framework, to avoid duplication, they would not be covered in the Revised Policy or Collateral Procedures.

4. Policy Governance

The Revised Policy would restate the Existing Policy's high level overall arrangements for policy governance, reviews and exception handling.

B. Collateral Procedures

The new Collateral Procedures would function as the application of the principles of the Revised Policy by describing the operational details and related governance processes for Permitted Cover, Haircuts and Concentration Limits that are currently in the Existing Policy and described below.

1. Permitted Cover

Detail regarding Permitted Cover requirements from the Existing Policy, and the adoption of the new Collateral Procedures, would not result in a change in the list of Eligible Permitted Cover. The Collateral Procedures would apply general eligibility criteria to Permitted Cover from the Existing Policy such as highly liquid assets, price history, capacity to revalue, etc. The Collateral Procedures also describe the additional criteria applied to financial instruments and gold assets currently in the Existing Policy.

The sovereign rating model has been retired by ICEEU and instead, the Procedures and related Parameters address sovereign quality. The elements related to sovereign rating are the same as in the Existing Policy and discussed in the new Collateral Procedures and Parameters.

Several other matters from the Existing Policy would not be described in the Collateral Procedures because they are found in other documents. Certain additional details and parameters would be set out in an annex to the Procedure or in the List of Permitted Cover, which is an operational document that is published on the ice.com website.⁵ Unlike the Existing Policy, the Collateral Procedures would not have a section specifically addressing restrictions on Guaranty Fund collateral as this is already addressed in the Finance Procedures and List of Permitted Cover.

2. Haircuts

As is currently the case with the Existing Policy, the proposed Collateral Procedures would apply conservative haircuts to Permitted Cover to ensure that, even in stressed market conditions, the collateral could be liquidated at least at the value it would be used to cover, and would also continue to apply cross-currency haircuts to mitigate foreign exchange risk where the currency applicable to the collateral would be different from the currency of the requirements it would be covering.

As is currently the case with the Existing Policy, the Collateral Procedures would state that ICEEU determines Haircuts using a combination of a model, analytical tools and/or qualitative overlays. The model would be described in the collateral and haircut model documentation and related parameters rather than being repeated in the Collateral

⁵ Available at: https://www.theice.com/publicdocs/clear_europe/list-of-permitted-covers.pdf

Procedures or Revised Policy. As is currently the case with the Existing Policy, the Collateral Procedures would provide that consistent with the existing model, Haircuts would further be based on a number of factors, including, but not limited to credit assessment of the issuer, market conditions, volatility, and liquidity of the underlying market.

These factors are substantially the same as those set out in the Existing Policy, other than the wrong way risk factor, which is addressed through an operational report, and is addressed through CM-specific measures rather than Haircuts.

Several other matters covered in the Existing Policy would not be included in the Revised Policy and Collateral Procedures. Haircuts would be subject to minimum values which would be addressed in the Parameters, instead of the Revised Policy or Collateral Procedures, and the final Haircut value would be rounded up to the nearest “Haircut Rounding Interval.” Certain additional requirements relating to Haircuts on bonds and gold bullion, as well as collateral pricing, which are currently addressed in the Existing Policy, would be removed from the Existing Policy as they are already addressed, and will continue to be addressed, in the Model and the Parameters. The list of data used in collateral pricing that is currently set out in the Existing Policy would instead be set out in the Parameters. The description of exceptions would be set out in Clearing House operational documentation.

As is currently the case with the Existing Policy, the Collateral Procedures would call for ICEEU to limit the likelihood of procyclical impact from Haircuts as issuer creditworthiness deteriorates and haircuts increase by applying a conservative minimum haircut, identifying potential future events, and providing notice of changes to haircuts.

3. Concentration Limits

The approach to Concentration Limits contained in the proposed Collateral Procedures would be substantially similar to the Existing Policy. However, certain details regarding the collateral breakdown report currently in the Existing Policy would not be included in the Collateral Procedures (as they are inconsistent with the level of detail in the Collateral Procedures generally) but would instead be set out in operational documentation. The report itself, which details how collateral values are produced at an operational level, will continue to be produced as part of the normal reporting cycle.

As is currently the case with the Existing Policy, the Collateral Procedures describe the framework for how ICEEU determines the absolute amount of each type of collateral that can be accepted from a CM (“Absolute Limits”) and the relative amount of each type of collateral within a CM’s collateral portfolio (“Relative Limits”). As compared to the Existing Policy, the Collateral Procedures would clarify that all markets cleared by ICEEU would be included in the calculation methodology for Absolute Limits. The description of the Absolute Limits in the Collateral Procedures would otherwise generally be consistent with the description of the Absolute Limits set out in the Existing Policy.

Additionally, unlike the Existing Policy, the Collateral Procedures would not take into account ICEEU’s committed repo facility as a basis for allowing Clearing Members to exceed otherwise applicable Absolute Limits.

4. Further Restrictions

As is currently the case with the Existing Policy, the Collateral Procedures would apply additional restrictions and measures with respect to collateral such as reducing

Absolute Limits once the CDS spread of the issuer breaches pre-defined levels and analyzing CMs' non-cash collateral to identify WWR daily.

The Collateral Procedures would also address cross clearing house concentration limits consistently with the manner in which they are addressed in the Existing Policy.

5. Data Management

While the Collateral Procedures restate from the Existing Policy that the sources of data used for collateral valuation and for Haircuts and Concentration Limits are approved and reviewed periodically at a senior level, valuation of collateral is outside the scope of the Collateral and Haircut Policy and Procedures and covered in the model documentation. The Existing Policy discussed the manner in which ICEEU monitored the value of collateral.

6. Daily Monitoring

Pursuant to the proposed Collateral Procedures, ICEEU would continue, from the Existing Policy, daily monitoring processes to ensure the eligibility of the list of Permitted Cover, to ensure the adequacy of Haircuts and to enforce the Concentration Limits

Certain details under Data and Reporting in the Existing Policy concerning the reports that are available to various stakeholders in the form of periodic Collateral Reports, will not be included in the Revised Policy or Collateral Procedures. The back testing of the haircut parameters currently set out in the Existing Policy would be instead set out in the Parameters (and the substance of those parameters is not proposed to be changed). Likewise, the description of the Risk Committee collateral reporting would be

governed through the Terms of Reference for committees instead of through the Revised Policy or Collateral Procedures (and is not otherwise proposed to be changed).

7. Governance

Governance relating to Permitted Cover, collateral and Haircuts would generally remain the same as in the Existing Policy, though the Collateral Procedures would add that competent authorities would be notified of any material breaches. Additionally, requirements under the Existing Policy relating to independent validation and policy review are covered in the Model Risk Governance Framework and Documentation Governance Schedule, and would not be addressed in the Revised Policy or Collateral Procedures.

8. Other Existing Policy Matters

Certain matters currently set out in the Existing Policy would be removed and addressed in documentation other than the Revised Policy or Collateral Procedures. Collateral management would be set out in the Treasury and Banking Services Policy and the Investment Management Procedures. The monitoring schedule would be set out in the Parameters. The description of the legal review of enforceability of collateral that was set out in the Existing Policy is generally considered to be business as usual work for the legal team and would no longer be covered through policies.

III. Commission Findings

Section 19(b)(2)(C) of the Act directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization. For the reasons given below, the Commission finds that

the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act⁶ and Rules 17Ad-22(e)(2), (e)(3), and (e)(5) thereunder.⁷

A. Consistency with Section 17A(b)(3)(F) of the Act

Section 17A(b)(3)(F) of the Act requires, among other things, that the rules of ICEEU be designed to promote the prompt and accurate clearance and settlement of securities transactions and, to the extent applicable, derivative agreements, contracts, and transactions, to assure the safeguarding of securities and funds which are in the custody or control of ICEEU or for which it is responsible, and, in general, to protect investors and the public interest.⁸

As described above, ICEEU's Existing Policy document is being split into the following two documents: (i) Revised Policy and new Collateral Procedures. The two new documents will separate the higher level policy principles from the specific procedures. In addition, neither the Revised Policy nor the new Collateral Procedures will contain information that is currently in other operational level documents. As a result of the proposed rule change, the Revised Policy and new Collateral Procedure will streamline but not materially alter the Existing Policy.

By clarifying and restating in a separate document its overall policy approach to the types, amounts and composition of cash and non-cash collateral that ICEEU accepts from CMs to cover their guaranty fund and margin requirements and by detailing the current procedures for applying that approach, the Commission believes the proposed

⁶ 15 U.S.C. 78q-1(b)(3)(F).

⁷ 17 CFR 240.17Ad-22(e)(2),(e)(3)(i),(e)(5).

⁸ 15 U.S.C. 78q-1(b)(3)(F).

rule change would continue, in an effective and focused way, ICEEU's ability to manage financial resources and ultimately its ability to clear and settle transactions. For example, the Collateral Procedures detailing eligibility criteria for Permitted Cover describe conservative standards such as assets that are highly liquid, have sufficient price history, have the capacity for daily revaluation, and are in eligible currency.

The Commission believes that this will help ICEEU focus procedurally to meet its obligations when liquidating collateral. Further, the factors upon which Haircuts will be based that are detailed in the Collateral Procedures include credit assessment of the issuer, maturity of the asset, volatility, liquidity of underlying market, stressed market conditions, preemptive application of potential future events, and application of conservative minimum haircut level to all collateral types. The Commission believes that this level of detail will help ICEEU continue to apply conservative haircuts to Permitted Cover to ensure that, even in stressed market conditions, the collateral could be liquidated to meet obligations while also limiting the likelihood of procyclical impacts from Haircuts as issuer creditworthiness deteriorates and haircuts increase.

Similarly, the approach to Concentration Limits detailed in the Collateral Procedures noted above sets a framework for how the limits are set and clarifies that all markets cleared by ICEEU would be included in the calculation methodology for Absolute Limits and that an individual CM's collateral portfolios would be balanced between different assets based on a qualitative assessment of the different types of collateral, taking into account factors such as the types of issuers, issuer credit risk and collateral liquidity and price volatility. The Commission believes that this sort of

information within its procedures continues and focuses ICEEU's ability to manage financial resources with a conservative approach to the permissible collateral pool.

The Commission also notes that it has previously found these policies and procedures consistent with the Act⁹ and because there are no material changes, believes that it continues to be consistent with the Act.

Therefore, for the reasons discussed above, the Commission finds that the proposed rule change would promote the prompt and accurate clearance and settlement of securities transactions, assure the safeguarding of securities and funds in ICEEU's custody or control, and, in general, protect investors and the public interest, consistent with the Section 17A(b)(3)(F) of the Act.¹⁰

B. Consistency with Rule 17Ad-22(e)(3)(i)

Rule 17Ad-22(e)(3)(i) requires that ICEEU establish, implement, maintain, and enforce written policies and procedures reasonably designed to, as applicable, maintain a sound risk management framework that identifies, measures, monitors, and manages the range of risks that it faces.

As described above, ICEEU's proposed Collateral Procedures, similar to the Existing Policy, continues to list various eligibility criteria for Permitted Cover, factors for determining Haircuts, and sets the framework for the amount of each type of collateral that can be accepted from a CM. The Commission believes that by proposing Collateral Procedures to follow in this regard, ICEEU will be able to continue, in a

⁹ Securities Exchange Act Release No. 74955 (May 13, 2015), 80 FR 28733 (May 19, 2015) (SR-ICEEU-2015-007).

¹⁰ 15 U.S.C. 78q-1(b)(3)(F).

streamlined and focused fashion, to mitigate collateral price and liquidation risk through setting acceptable Permitted Cover, Haircuts and Concentration Limits and providing guidelines for monitoring these measures and managing any deviations or related issues. The Commission also believes that by documenting the management of its collateral liquidation risks in this way, ICEEU generally enhances its financial stability by ensuring that the collateral it accepts from CMs continues to adequately meet its obligations.

For these reasons, the Commission finds that the proposed rule change is consistent with Rule 17Ad-22(e)(3)(i).¹¹

C. Consistency with Rule 17Ad-22(e)(5)

Rule 17Ad-22(e)(5) requires that ICEEU establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, limit the assets it accepts as collateral to those with low credit, liquidity, and market risks, and set and enforce appropriately conservative haircuts and concentration limits if the covered clearing agency requires collateral to manage its or its participants' credit exposure; and require a review of the sufficiency of its collateral haircuts and concentration limits to be performed not less than annually.¹²

The Commission believes that the factors and other considerations noted above as described in the proposed Collateral Procedures with respect acceptable Permitted Cover, Haircuts, and Concentration Limits, including low credit risk of assets, transferability of assets, market conditions, and expectations of future volatility, will continue to maintain ICEEU's ability to limit the assets it accepts as collateral to those with low credit,

¹¹ 17 CFR 240.17Ad-22(e)(3)(i).

¹² 17 CFR 240.17Ad-22(e)(5).

liquidity, and market risks, and set and enforce appropriately conservative haircuts and concentration limits. Further, the Revised Policy and Collateral Procedures continue to provide that Concentration Limits be reviewed at least monthly at a senior level and Permitted Cover, Haircuts and Concentration Limits are subject to regular reviews and monitoring and changed ad-hoc if needed.

For these reasons, the Commission finds that the proposed rule change is consistent with Rule 17Ad-22(e)(5).¹³

D. Consistency with Rule 17Ad-22(e)(2)

Rule 17Ad-22(e)(2) requires, among other things, that ICEEU establish, implement, maintain, and enforce written policies and procedures reasonably designed to provide for governance arrangements that are clear and transparent and specify clear and direct lines of responsibility.¹⁴

As noted above, similar to the Existing Policy, the proposed Revised Policy and the Collateral Procedures continue to describe the governance relating to Permitted Cover, Haircuts, and Concentration Limits. Specifically, the Revised Policy provides that the document owner is responsible for ensuring that it remains up-to-date and is reviewed in accordance with ICEEU's governance processes and will report material breaches or unapproved deviations from this Policy to their Head of Department, the Chief Risk Officer and the Head of Compliance (or their delegates) who together will determine if further escalation should be made to relevant senior executives, the Board and/or competent authorities. Further, the proposed Collateral Procedures state that

¹³ 17 CFR 240.17Ad-22(e)(5).

¹⁴ 17 CFR 240.17Ad-22(e)(2)(i) and (v).

proposals to add, remove, change, or set Permitted Cover, Haircuts or Concentration Limits are reviewed and approved at a senior level and amendments would be published where practicable by circular in advance of taking effect to CMs and relevant competent authorities. The Commission therefore believes that this continues to maintain ICEEU's policies and procedures in a manner reasonably designed to provide for governance arrangements that are clear and transparent and specify clear and direct lines of responsibility.

For these reasons, the Commission finds that the proposed rule change is consistent with Rule 17Ad-22(e)(2).¹⁵

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act, and in particular, with the requirements of Section 17A(b)(3)(F) of the Act¹⁶ and Rules 17Ad-22(e)(3)(i), (e)(5), and (e)(2) thereunder.¹⁷

¹⁵ 17 CFR 240.17Ad-22(e)(2).

¹⁶ 15 U.S.C. 78q-1(b)(3)(F).

¹⁷ 17 CFR 240.17Ad-22(e)(3)(i),(e)(5),(e)(2).

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Act¹⁸ that the proposed rule change (SR-ICEEU-2019-019) be, and hereby is, approved.¹⁹

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁰

J. Matthew DeLesDernier,

Assistant Secretary.

¹⁸ 15 U.S.C. 78s(b)(2).

¹⁹ In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

²⁰ 17 CFR 200.30-3(a)(12).

[FR Doc. 2020-02748 Filed: 2/11/2020 8:45 am; Publication Date: 2/12/2020]